



Sunrise

Monday, 27 March 2017

Rates: How strong is market's faith in reflation trade?

Asian risk sentiment deteriorated after the initial tepid reaction to the Republican health care downfall. This failure could signal problems ahead for Trump's economic agenda and might falter markets' faith in the reflation trade. That could underpin US Treasuries. In yield terms, the US 10-yr yield could be up for a test of 2.3% support this week.

Currencies: Dollar correction continues after failed Trumpcare vote

The dollar is fighting an uphill battle in Asia this morning after Friday's failure of the Republicans to repeal Obamacare in a House vote. USD/JPY dropped below support. EUR/USD is challenging the important 1.0829/74 resistance. The day-to-day momentum is clearly dollar negative. However, we expect any further gains of EUR/USD to be modest and gradual.

Calendar

Headlines

S&P	↔
Eurostoxx 50	↔
Nikkei	↓
Oil	↔
CRB	↔
Gold	↑
2 yr US	↔
10 yr US	↓
2yr DE	↔
10 yr DE	↔
EUR/USD	↔
USD/JPY	↓
EUR/GBP	↔

- **US stock markets closed mixed** and didn't suffer a late setback as the vote on a new Republican health care bill was pulled just before the close. **Overnight**, Asian stock markets lose up to 0.5% as **risk aversion takes the upper hand**.
- **House Republicans stumbled in their first major attempt to reshape the US government** under President Trump, as their long-promised health-care bill failed despite days of personal lobbying by the president and Speaker Paul Ryan.
- With the corpse of Republican's failed efforts to pass healthcare legislation still warm, **President Trump says he is already preparing to move on to the next item on his policy to-do list: tax reform**.
- **German Chancellor Merkel's CDU scored a clear victory in the small state of Saarland**, dashing hopes among her contenders that the election would signal a change of political sentiment ahead of a national vote in September.
- **China will substantially cut the number of sectors closed to foreign investment**, PBOC governor Zhou Xiaochuan said. He added though that as his country opens wider, "we want China to get fair treatment overseas".
- A joint committee of ministers from **OPEC and non-OPEC oil producers has agreed to review whether a global pact to limit supplies should be extended** by six months. Brent crude hovers just above the psychological \$50/barrel mark.
- **Today's eco calendar is thin** with German Ifo business sentiment and EMU M3 money supply data. ECB Praet and Fed Evans are scheduled to speak. The US Treasury starts its refinancing operation with a \$26B 2-yr Note auction.

Rates

Modest reaction on cancellation health care bill vote

Global core bonds traded with a small upward bias on Friday, ignoring mixed eco data. EMU PMI's recorded another monthly increase, matching the highest level since Q1 2011. US durables goods orders also surprised on the upside, but the forward looking capital goods orders component disappointed. Neither eco report triggered market reaction as worsening prospects for the passing of the health care bill dominated. **Late in the US session, House speaker Ryan pulled the health care bill vote, triggering a sell the fact reaction in the US Treasury and equity market. Equities nevertheless closed narrowly mixed, off the lows. The dollar rebounded on the news to close nearly unchanged.** Markets' faith in Trump's reflation policy isn't completely gone yet. **In a daily perspective,** the German yield curve bull flattened slightly with yields between 0.6 bps (2-yr) and 2.8 bps (30-yr) lower. Changes on the US yield curve varied between +0.5 bps (2-yr) and -1.6 bps (30-yr). **On intra-EMU bond markets,** 10-yr yield spread changes versus Germany narrowed up to 4 bps (Portugal). Portugal recorded its smallest budget deficit in 40 years.

US Treasuries and Bunds modestly higher

German Bunds slightly outperform US Treasuries

Peripheral bond spreads narrow

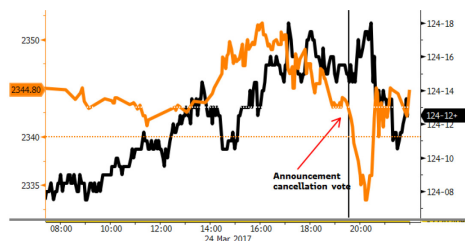
	US yield	-1d
2	1,23	-0,04
5	1,89	-0,07
10	2,36	-0,07
30	2,97	-0,07

Upside risk EMU German IFO

	DE yield	-1d
2	-0,74	-0,01
5	-0,32	-0,01
10	0,39	-0,04
30	1,13	-0,04

German IFO main release of the day

The March German IFO business sentiment headline composite index is expected to stabilize at 111.1 with a slight increase in the current situation sub-index compensated by a slight decline of the expectations sub-index. Following Friday's stronger than expected German PMI survey, we put the **risks on the upside of consensus.** If correct, it would bring the index to the tops registered in 2007 and 2010. The **euro area M3 money supply** is interesting, but no market mover. We especially look for signs that loans to households and business are accelerating. Regarding central bankers, ECB Praet and Fed Evans will speak. The latter spoke already a few times in the past days and should not bring new info. Regarding **ECB Praet,** we will scrutinize whether he will try to push back on growing market expectations that the stronger eco data might accelerate the exit policy.



T-Note future (black) & S&P future (orange) (intraday): US Treasuries up ahead of vote, but fell slightly once equities rebounded.



German 10-yr yield: Off sideways range top (0.50%) but still close to top. Loss of uptrendline, if confirmed, would point to more sideways trading between 0.2%-0.5%, our favoured scenario.

US 2-yr Note auction

R2	164,40	-1d
R1	163,12	
BUND	160,6	0,57
S1	158,28	
S2	157,28	

The US Treasury starts its end-of-month refinancing operation today with a \$26B 2-yr Note auction. Currently, the WI trades around 1.25%. Tomorrow; the Treasury continues with a \$34B 5-yr Note auction. On Wednesday, they conclude with a \$13B 2-yr FRN auction and a \$28B 7-yr Note auction.

This week's scheduled EMU bond supply comes from Germany, Finland and Italy. Tomorrow, the German Finanzagentur holds a €4B 2-yr Schatz auction (€4B 0% Mar2019). On Wednesday, the Finnish treasury holds a 7-yr RFGB auction (€1B 0% Sep2023). On Thursday, the Italian debt agency concludes the supply operation, but bonds and the amount on offer still need to be communicated.

How strong is market's faith in reflation trade?

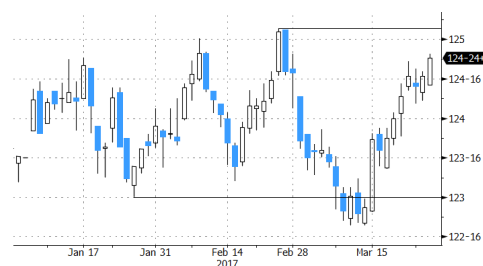
Overnight, Asian risk sentiment deteriorated after the initial tepid reaction to the Republican health care downfall. Asian stock markets lose up to 0.5% with Japan underperforming on a stronger yen. USD/JPY slides further, hitting new short term lows (see FX). US Treasuries eke out gains. **We expect a stronger opening for the Bund.**

Today's calendar contains German Ifo business sentiment (upside risks) and EMU M3 money supply data. We don't expect the data or central bank speakers (ECB Praet & Fed Evans) to influence trading. **The Republican failure to push the health care bill through could signal problems ahead for Trump's economic agenda and might falter markets' faith in the reflation trade.** That could underpin US Treasuries this week. In yield terms, the US 10-yr yield could be up for a test of 2.3% support e US 10-yr yield. That could be an opportunity to position again for higher US yields.

Technically, **we expect the US 10-yr yield to trade in the 2.3%-2.64% range. Longer term, we maintain our scenario of 4 rate hikes in 2017 and higher long term yields.** The German 10-yr yield moved at a rapid pace from the 0.2% lower bound of the sideways range towards the 0.5% upper bound, but a break didn't occur. **Like in the US, we expect range trading ahead of the French elections.** Comments on the central bank's exit strategy could still influence the front end of the European yield curve. **The March ECB meeting and recent talk by ECB comforted our call that another "calibration" of the ECB's QE programme will happen in H2 2017.**



German Bund: Short term positive momentum via safe haven flows?



US Note future: Heading towards 125-04+ resistance (2.3% support US 10-yr yield) as markets' faith in the reflation trade falters?

Currencies

On Friday, dollar didn't go anywhere as markets pondered to outcome of the Trump-care bill

R2	1,1145	-1d
R1	1,0874	
EUR/USD	1,0846	0,0083
S1	1,0341	
S2	1,0000	

USD suffers in Asia this morning as post-Trumpcare fall-out weighs

Ifo most important data release today

Fall-out from the US healthcare failure will continue dominating USD trading today

USD selling persists after failed Trumpcare vote

On Friday, trading in major USD cross rates remained in wait-and-see modus, ahead of the vote on the US healthcare bill. EUR/USD gained slightly ground on strong EMU PMI's. The House not voting on the bill to replace Obamacare initially had only a modest impact. Markets apparently concluded/hoped that tax reform would become a priority for the Trump administration. EUR/USD finished the session at 1.0798 (from 1.0783). USD/JPY even closed the session off the intraday lows at 111.34 (from 110.94).

Overnight, Asian markets don't share the relative resilience of the US markets late on Friday evening. US Treasury yields and the dollar are declining. Regional equities ex Japan trade with modest losses. The weaker dollar is a mixed factor for regional equities. USD/JPY is taking the lead in the USD decline. The pair trades currently in the 110.30 area. So, the 111.60/39 range bottom is really broken. The loss of the dollar against the euro is more moderate. The pair trades in the 1.0845 area.

Today, the market calendar is light, but **German IFO business sentiment** is worth mentioning. The market expects a stabilization of the headline composite index at 111.1. Following Friday's stronger than expected PMI, we put the **risks on the upside of consensus**. If correct, it would bring the index to the tops registered in 2007 and 2010. We will also scrutinize quotes from ECB's Peter Praet, whether he will push back on rising market expectations that the stronger eco data might accelerate the exit policy.

In a day-to-day perspective, a good Ifo confidence might be slightly euro supportive (as was the case for the PMI's on Friday). **However, the focus will be on the political impact of the failure to replace Obamacare**. The dollar will probably stay under pressure in early Europe as investors adapt positions further after the failed Trumpcare vote. **US equity futures** also show substantial losses, indicating a further correction on the reflation trade. **Will this correction accelerate in the US? The daily momentum on US equities and on the dollar is clearly negative, but maybe the correction shouldn't go that far.** US **bond yields** are nearing important support levels that probably won't give away that easily. At the same time, the Trump administration might step up its efforts to cling a victory on other key policy topics like taxes. So, the USD momentum is negative and we don't row against the tide at this stage. **However, we don't expect an aggressive USD sell-off.**



EUR/USD: topside test of 1.0829/74 resistance after failed "Trumpcare" vote



USD/JPY: break of 111.36/60 support confirmed

From a technical point of view, the picture of USD/JPY is worrisome as it clearly dropped below the 111.60/36 support. Next support is coming in at 108.84 (50% retracement of the MT up-move). EUR/USD jumped above the 1.0829 level (2017 top) with the next key reference coming in at 1.0874. A break beyond this level would deteriorate the MT picture for the dollar. Chances on a break of this level are growing. However, we don't expect a real protracted rally of the euro and the dollar already at this stage. The absolute interest rate differential between the US and Germany/European makes EUR/USD long costly. At the same time, we also don't see the euro as the perfect safe haven yet.

Sterling rebound to slow?

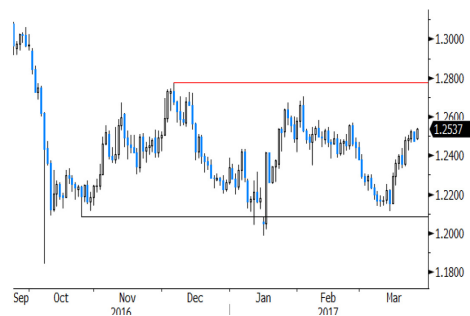
R2	0,8881	-1d
R1	0,8854	
EUR/GBP	0,8657	0,0031
S1	0,8592	
S2	0,8304	

On Friday, dovish comments from BoE's Vlieghe caused some profit taking on the recent sterling rally. Admittedly most of the correction occurred in (thin) Asian trading. Cable settled in a tight range close to, mostly slightly below the 1.25 barrier. The rebound of EUR/GBP continued during the morning session due to broader euro gains after the strong EMU PMI's. EUR/GBP returned to mid-0.86 area and closed the session at 0.8657 (from 0.8612).

Overnight, EUR/GBP opened stronger in Europe, as a cautious risk sentiment and a broader bid for EUR/USD supported the pair. However, for now there are no follow-through gains. There are no important eco data in the UK today. So, sterling will probably be driven by global factors (risk-off). Markets will also look forward to the next steps in the Brexit-procedure. Two weeks ago, sterling found a better bid after the early March decline. Some time ago, EUR/GBP cleared 0.8592 resistance, improving the MT technical picture. However, a (substantially) higher than expected UK inflation probably put a decent floor for sterling short-term. We changed our short-term bias on EUR/GBP from positive to neutral. Some further consolidation in the 0.85/0.88 area might be on the cards. Longer term, Brexit-complications remain a potential negative for sterling, but this issue isn't in the spotlights right now. We are not convinced that the BoE will raise rates anytime soon, even not after this months' higher inflation data.



EUR/GBP: sterling rebound to show tentative signs of slowing?



GBP/USD: USD weakness prevails

Calendar

Monday, 27 March		Consensus	Previous
Japan			
01:50	PPI Services YoY (Feb)	A: 0.8%	0.5%
EMU			
10:00	M3 Money Supply YoY (Feb)	4.9%	4.9%
Germany			
10:00	IFO Business Climate (Mar)	111.1	111.0
10:00	IFO Expectations (Mar)	104.3	104.0
10:00	IFO Current Assessment (Mar)	118.3	118.4
Events			
19:00	US to Sell \$26B 2-yr Notes		
14:00	ECB's Praet speaks in Madrid (also at 19h15 panel discussion)		
19:15	Fed's Evans Speaks on Economy and Policy in Madrid		

10-year	<u>td</u>	<u>-1d</u>		2-year	<u>td</u>	<u>-1d</u>	Stocks	<u>td</u>	<u>-1d</u>
US	2,36	-0,07		US	1,23	-0,04	DOW	20596,72	-59,86
DE	0,39	-0,04		DE	-0,74	-0,01	NASDAQ	5828,738	11,05
BE	0,87	-0,04		BE	-0,49	-0,02	NIKKEI	18985,59	-276,94
UK	1,20	-0,03		UK	0,17	0,01	DAX	12064,27	24,59
JP	0,06	-0,01		JP	-0,26	0,00	DJ euro-50	3444,15	-8,03
IRS	<u>EUR</u>	<u>USD</u>	<u>GBP</u>	EUR	<u>-1d</u>	<u>-2d</u>	USD	<u>td</u>	<u>-1d</u>
3y	0,03	1,77	0,74	Eonia	-0,3560	0,0010			
5y	0,26	2,02	0,92	Euribor-1	-0,3720	0,0010	Libor-1	0,9828	-0,0011
10y	0,81	2,34	1,26	Euribor-3	-0,3300	0,0000	Libor-3	1,1513	-0,0055
				Euribor-6	-0,2420	0,0000	Libor-6	1,4271	-0,0042
Currencies	<u>td</u>	<u>-1d</u>		Currencies	<u>td</u>	<u>-1d</u>	Commodities	<u>td</u>	<u>-1d</u>
EUR/USD	1,0846	0,0083		EUR/JPY	119,61	-0,21	CRB	183,47	-0,18
USD/JPY	110,28	-1,05		EUR/GBP	0,8657	0,0031	Gold	1260,60	15,20
GBP/USD	1,2529	0,0052		EUR/CHF	1,0714	-0,0002	Brent	50,38	-0,23
AUD/USD	0,763	0,0013		EUR/SEK	9,5268	0,0044			
USD/CAD	1,3332	-0,0036		EUR/NOK	9,173	0,0140			

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